

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

* * * * *

In the Matter of:

THE APPLICATION OF THE PULASKI COUNTY)	
WATER DISTRICT NO. 2, A WATER DISTRICT)	
ORGANIZED PURSUANT TO CHAPTER 74 OF THE)	
KENTUCKY REVISED STATUTES, OF PULASKI)	
COUNTY, KENTUCKY, FOR (1) A CERTIFICATE)	
OF PUBLIC CONVENIENCE AND NECESSITY,)	
AUTHORIZING AND PERMITTING SAID WATER)	
DISTRICT FOR ADDITIONS AND IMPROVEMENTS)	
TO THE WATERWORKS DISTRIBUTION SYSTEM,)	CASE NO. 9199
CONSISTING OF PUMPING STATIONS, WATER)	
STORAGE TANKS AND THE NECESSARY DISTRIBUTION)	
SYSTEM AND LINES NEEDED TO SERVE)	
WATER TO SAID DISTRICT EXPANSION AREA,)	
(2) APPROVAL OF THE PROPOSED PLAN OF)	
FINANCING OF SAID PROJECT, AND (3))	
APPROVAL OF THE WATER RATES PROPOSED TO)	
BE CHARGED BY THE DISTRICT TO CUSTOMERS)	
OF THE DISTRICT)	

O R D E R

The Pulaski County Water District No. 2 ("Pulaski County") filed an application on November 5, 1984, for approval of adjustments to its water service rates, authorization to construct a \$1,685,930 waterworks improvement project, and approval of its financing for the proposed project. An Interim Order was issued on March 21, 1985, granting a Certificate of Public Convenience and Necessity to proceed with the waterworks construction projects and approval of Pulaski County's financing plan.

The proposed rates are calculated to produce estimated additional revenue of approximately \$76,094 annually, an increase of 45.4 percent over normalized test-year operating revenue.

Based upon the determination herein, Pulaski County has been granted the entire amount of the proposed increase.

Hearings were held in the offices of the Public Service Commission, Frankfort, Kentucky on March 13, 1985, and May 14, 1985. There were no intervenors in this proceeding. At the hearings, certain requests for additional information were made. This information has been filed.

COMMENTARY

Pulaski County is a water district organized and existing under the laws of the Commonwealth of Kentucky and currently serves 724 customers in Pulaski County, Kentucky. The proposed extension will increase the number of customers served by Pulaski County to 1,307.

TEST PERIOD

Pulaski County has proposed and the Commission has accepted the 12-month period ending December 31, 1984, as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

REVENUES AND EXPENSES

For the test period, Pulaski County reported a net operating loss of \$18,417. Pulaski County proposed several pro forma adjustments to revenues and expenses to reflect more current and anticipated operating conditions. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Purchased Water

Pulaski County proposed to increase the purchased water expense by \$42,790, based upon an average residential customer cost of \$77.14 applied to a proposed increase in new customers of 555.¹ Since the preparation of the application, Pulaski County has revised the proposed increase in new customers to 583.²

In determining the purchased water expense associated with the new customers, Pulaski County calculated the average cost of water per residential customer by multiplying the percentage of usage of residential customers to all customers by the total water cost. This cost was then divided by the average number of residential customers for the test period. This methodology results in an inaccurate projection of purchased water expense because it is based upon a percentage of the purchased water expense for the test period. A preferable method to calculate the adjustment is to apply the cost of water to the average test period consumption per residential customer, adjusted for line loss, times the proposed increase in customers. This method is more directly related to the expense and, therefore, more accurate than the method proposed by Pulaski County. Furthermore, since the estimate of additional customers has increased to 583, the Commission is of the opinion that the adjustment would be more reasonable based on

¹ Response to Commission's Order dated March 28, 1985, Item No. 10.

² Response to Commission's Order dated February 20, 1985, Item No. 22.

the revised number of additional customers. This method results in an adjustment to increase test-period purchased water expense by \$45,662.

Power for Pumping

Pulaski County proposed an adjustment to increase the cost of Power for Pumping Expense by \$889. The adjustment was calculated by multiplying the percentage of residential consumption to total consumption, by the total power expense. This amount was divided by the average number of residential customers to arrive at a per-residential customer cost. This cost was then increased by 10 percent due to the increase in the distance pumped and then multiplied by the 555 new residential customers. This amount was then added to the test-period pumping expense associated with the commercial and industrial customers to arrive at the pro forma expense. When Mr. Norman Ard, the accountant for Pulaski County, was asked during the hearing how the 10 percent increase was determined, he replied that it was an estimate.³

The projected power for pumping expense adjustment is not known and measurable since there is no direct relationship between the power for pumping expense and per-residential customer usage. A preferable method of determining projected power for pumping expense based upon the additional KWH usage of the new pump would be considered by the Commission. However, due to insufficient information having been submitted by Pulaski County, the appropriate calculations could not be made. Therefore, the proposed

³ Transcript of Evidence, May 14, 1985, p. 34.

adjustment to power purchased for pumping has not been included in the operating expenses for rate-making purposes herein.

Operation Supplies and Expense

Office Supplies and Expense

Miscellaneous Expense

Pulaski County proposed adjustments to Operation Supplies and Expense, Office Supplies and Expense, and Miscellaneous Expense based upon the proposed increase in customers. The adjustment was based on the actual per-customer cost incurred during the test period. Pulaski County did not provide any evidence showing the direct relationship of these expenses to the number of customers receiving service. Even though it can be expected to have some increase in these expenses, it is the Commission's opinion that the adjustments proposed by Pulaski County to these various expenses are not sufficiently known and measurable and, therefore, have not been included in the operating expenses for rate-making purposes.

Maintenance of Pumping Plant

Pulaski County proposed an adjustment to increase Maintenance of Pumping Plant expense by \$227. The proposed adjustment was determined by multiplying the percentage increase in gallons of water sold due to the additional customers by the average pumping plant expense over the past 2 years. An adjustment to this account is extremely speculative since the historical cost was based on old lines whereas the lines in the new extension will probably require only minimal maintenance in the first years of operation. Pulaski County provided no support for the need for

this adjustment and, in addition, never explained why the adjustment should be based on the average cost over the past 2 years. The changes to this account have been very uneven during the past 4 years, as evidenced by the fact that the 1981 expense was \$164, 1982 was \$771, 1983 was \$395, and the test-year expense was \$285. It is the Commission's opinion that a known and measurable adjustment cannot be made to this account based upon the aforementioned items. Therefore, the adjustment proposed by Pulaski County for the Maintenance of Pumping Plant has not been included for rate-making purposes herein.

Operation Labor and Meter Reading Labor

Pulaski County includes in the Operation Labor account the manager's salary and the expense for having its two tank sites mowed. Due to the two additional tank sites included in the proposed construction, the mowing expense is projected to double the actual test-year amount. This proposed adjustment of \$180 is known and measurable and, therefore, has been included herein for rate-making purposes.

During the first 11 months of the test year, Pulaski County hired two employees to serve as manager and meter reader. In December, another individual was hired to replace the previous employees, combining the two positions. The new manager is currently being paid \$1,000 per month for performing both functions. During the test period the manager was paid \$1,000 per month and the meter reader worked on a contract basis. It was estimated by Pulaski County that the manager's functions, excluding meter

reading, require 32 hours per week, and that the estimated hours per week required, including meter reading, is 40.⁴

Pulaski County has proposed to increase the manager's salary by 50 percent due to the fact that additional time will be required to supervise the expanded system. The following was stated in the application:

Meter reading on present system is to be done by present manager at no additional cost. This has in the past been done by additional personnel on a contract basis. Meters on the extended system will be on a self-reading basis at no additional⁵ cost; therefore, this expense has been eliminated.

Pulaski County provided no further justification for increasing the manager's salary by 50 percent.

Even though it can be expected that the manager's duties will increase some due to the extension, the total hours worked by the two employees during the test period were the equivalent of one full-time employee, which is the projected personnel needs after the expansion. No evidence was provided that the new manager's salary had been increased to the proposed level. Therefore, the Commission is of the opinion that no increase in this expense has been justified. An adjustment has been made to reduce this expense by \$3,192 to exclude meter reading salaries since the present manager is performing that duty under the new organizational structure.

⁴ Response to Commission's Order dated March 28, 1985, Item No. 6.

⁵ Application, Exhibit No. 2.

Transmission and Distribution Expense-
Operation Supplies and Expense

Pulaski County proposed an adjustment to the Transmission and Distribution Expense-Operation Supplies and Expense of \$48 based upon a 34.8 percent increase in gallons to be used due to the additional customers. Pulaski County provided no support for basing this adjustment on the percentage increase in gallons to be used. It is the Commission's opinion that this adjustment cannot be considered known and measurable; therefore, the Commission has not included the proposed adjustment in the projected operating expenses for rate-making purposes herein.

Maintenance of Mains Expense

Pulaski County proposed an adjustment to the Maintenance of Mains Expense of \$4,314 based upon a 100 percent increase in the last 3-year average. The 3-year average was not materially different from the actual test-year expense. Mr. Ard stated during the hearing that the projected 100 percent increase in this account is strictly an estimate.⁶ It is the Commission's opinion that only known and measurable adjustments should be included for rate-making purposes and thus the adjustment was not included in the projected operating expenses herein.

Maintenance of Meters Expense

Pulaski County proposed an adjustment to the Maintenance of Meters Expense of \$580 based upon the historical average cost per customer for meter maintenance over the past 3 years. The 3-year

⁶ Transcript of Evidence, May 14, 1985, p. 22.

average cost per customer was increased to include the 555 additional customers based on the average cost per customer. Mr. Ard stated during the hearing that no consideration was given to the fact that the meters to be installed on the extension would be new meters and would, theoretically, have a lower maintenance cost.⁷ It is the Commission's opinion that Pulaski County has not provided sufficient information to show that the adjustment is known and measurable. Therefore, the adjustment has not been included herein for rate-making purposes.

Maintenance of Hydrants Expense

Pulaski County proposed an adjustment to the Maintenance of Hydrants Expense of \$<1,168>. The proposed adjustment to this account was based upon the average cost per mile of line over the past 17 years with a 73.68 increase due to the increase in miles of lines. No expense was reflected in this account until 1983.

Mr. Ard stated during the hearing that the additional number of hydrants in service due to the extension was not considered, even though this would have been a proper method. He also agreed that the expense for the test year was abnormal and should have been capitalized. By taking the past 17-year average, Mr. Ard stated that they were, in effect, capitalizing the expense of the test year.⁸

Based upon the aforementioned items, the Commission is of the opinion that the proposed adjustment, based upon the

⁷ Transcript of Evidence, May 14, 1985, p. 36.

⁸ Transcript of Evidence, May 14, 1985, p. 25.

percentage increase in water mains, is not known and measurable and has not been included for rate-making purposes. Furthermore, due to the abnormal nature of the test-year expense, it has been capitalized and depreciated over 17 years. Thus, the Maintenance of Hydrants Expense has been reduced by \$1,410 and the total depreciation expense increased by \$83.

Accounting and Collection Expense

Accounting and collection is done by South Kentucky RECC on a per-transaction basis. Pulaski County proposed an adjustment to the Accounting and Collection Expense based upon the proposed increase in customers on a per-customer cost basis. Pulaski County calculated the adjustment in the application based upon 555 additional customers. It is the Commission's opinion that this adjustment is known and measurable and should be allowed. However, in determining the adjustment, the Commission has used the revised number of additional customers of 583, thus resulting in an increase in the Accounting and Collection Expense of \$7,626.

Depreciation Expense

Pulaski County proposed an adjustment of \$33,660 to depreciation expense for the new extension. Actual test-period depreciation expense was \$13,740 based on depreciation of total plant-in-service. The Commission is of the opinion that allowable depreciation expense for rate-making purposes should be calculated only on plant funded with capital other than Contributions In Aid of Construction. Such a method insures that ratepayers pay only for the plant in which the utility has made an investment and not the plant which the utility has acquired at no cost. At the end

of the test period, the ratio of Contributions in Aid of Construction to adjusted plant-in-service, including the amounts associated with the extension, is 62.1 percent. The Commission has reduced the adjusted depreciation expense by 62.1 percent to exclude depreciation on contributed property, and has increased depreciation by \$83 to reflect the \$1,410 adjustment to plant-in-service for the capitalization of costs erroneously recorded as Maintenance of Hydrants Expense. The net result is to increase Depreciation Expense by \$7,792, to \$21,532.

Interest Income

Pulaski County accounts for the interest income on customer advances for construction by adding the income to the Account No. 132--Temporary Cash Investment. This income is not currently included in the operating statement. Pulaski County's reasoning for this treatment is that these funds are advancements for construction of the new line by prospective customers and are subject to refund if the extension is not made. All interest on non-restricted funds, a \$30,000 Certificate of Deposit, and the checking account, are recorded in Account No. 959--Interest Income.⁹ Pursuant to the Uniform System of Accounts, interest revenue on advances shall be reported to the Interest Income account. Therefore, in the future, Pulaski County shall report any interest income on the advances from customers in the Interest Income account and thus include it in the operating statements.

⁹ Response to Commission's Order dated March 28, 1985, Item No. 3.

Pulaski County has not proposed an adjustment to the Interest Income account, which includes interest from the \$30,000 Certificate of Deposit and interest from the checking account. Since the \$30,000 Certificate of Deposit was apparently purchased during the beginning of the test year, only one of the semi-annual interest income payments was recorded in July 1984. The other semi-annual interest income payment was recorded in January 1985. In order to normalize the interest income, the interest income from the Certificate of Deposit for the test period was increased by \$1,503 to reflect a full year's interest income realization. This amount has been included as interest income for rate-making purposes.

Miscellaneous Service Revenue

Pulaski County proposed an adjustment to Miscellaneous Service Revenue of \$458. The proposed adjustment was based upon the 555 additional customers of an average per-customer revenue of 83 cents. It is the Commission's opinion that the number of reconnection service charges will vary, depending upon the number of customers and, therefore, an adjustment is appropriate. However, Pulaski County calculated the adjustment in the application based upon 555 additional customers. For rate-making purposes, the adjustment has been recalculated using the revised number of 583 additional customers. Thus, the Miscellaneous Service Revenue account has been increased by \$486, to \$1,066.

Amortization of Rate Case Expense

Pulaski County reports total legal and accounting expenses of \$8,422 associated with this proceeding. The Commission is of the opinion that this cost should be recovered through amortization over a 3-year period for rate-making purposes. Therefore, an adjustment has been made to increase operating expenses by \$2,807 for rate-making purposes.

After consideration of the aforementioned adjustment, the Commission finds Pulaski County's adjusted test-period operations to be as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$118,266	\$ 77,898	\$196,164
Operating Expense	138,647	59,234	197,881
Net Operating Income	<u>\$<20,381></u>	<u>\$ 18,664</u>	<u>\$< 1,717></u>
Interest Income	1,963	1,503	3,466
Interest Expense	-0-	<72,960>	<72,960>
Net Income	<u><u>\$<18,418></u></u>	<u><u>\$<52,793></u></u>	<u><u>\$<71,211></u></u>

REVENUE REQUIREMENTS

The Commission is of the opinion that the adjusted test-period operating loss is clearly unjust and unreasonable. Historically, the Commission has used the debt-service coverage ratio as the criterion for determining revenues for non-profit water utilities, and it finds no reason to deviate from this method in this proceeding. Using a debt-service coverage of 1.2 plus operating expenses, the Commission finds Pulaski County's total revenue requirement to be a maximum of \$291,434. The revenue increase requested by Pulaski County will generate \$2,131 less than the maximum which the Commission would have found

reasonable. However, the Commission is of the opinion and finds that the revenue increase requested by Pulaski County will produce gross annual revenue sufficient to pay Pulaski County's operating expenses, service its debt, and provide a reasonable surplus for equity growth, and should therefore be approved.

RATE STRUCTURE

Pulaski County's rate structure allows for a separate gallonage allowance and minimum bill to be charged to each classification of customer. Pulaski County's present and proposed rate structure allows a minimum usage of 5,000 gallons for commercial customers and 20,000 gallons for industrial customers.

The Commission is of the opinion that a minimum usage allowance and a minimum charge for the various customer classifications based on capacity flow of the various size meters is fair; however, the Commission has determined that these minimum bills should be equal to a bill for the same usage calculated through the general rate schedule. Therefore, the Commission has adjusted the minimum bills for the 5,000 gallon and 20,000 gallon usage allowances to correspond with the price charged through the general rate schedule.

FINDINGS AND ORDERS

The Commission, after consideration of the application and evidence of record and being advised, is of the opinion and finds that:

1. The rates in Appendix A are fair, just and reasonable rates for Pulaski County and will produce annual water revenue of approximately \$286,302.

2. The minimum usage proposed by Pulaski County would not provide equal minimum bills calculated through the general rate schedule and, therefore, the Commission has adjusted the minimum bills for the 5,000 gallon and 20,000 gallon usage allowances to correspond with the price charged through the general rate schedule.

3. Pulaski County plans to finance the project on an interim basis in anticipation of the issuance of the bonds, which were approved by the Interim Order entered on March 21, 1985, by the issuance of \$778,000 of bond anticipation notes with maturities not exceeding 3 years and bearing interest at 9 1/2 percent annually.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Pulaski County on and after the date of this Order.

IT IS FURTHER ORDERED that within 30 days from the date of this Order Pulaski County shall file with the Commission the revised tariff sheets setting out the rates approved herein.

IT IS FURTHER ORDERED that Pulaski County may issue bond anticipation notes in a total amount not exceeding \$778,000, bearing interest at a rate not exceeding 9 1/2 percent per annum payable semiannually and maturing no later than 3 years from the date of issue, payable from the revenues of the District Waterworks System and from the first proceeds of such revenue bonds issued in an amount not exceeding \$778,000.

Done at Frankfort, Kentucky, this 30th day of August, 1985.

PUBLIC SERVICE COMMISSION

Richard D. Lemons
Chairman

W. A. G. G. G.
Vice Chairman

James H. Whitcomb
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 9199 DATED AUGUST 30, 1985

The following rates and charges are prescribed for the customers in the area served by Pulaski County Water District No. 2. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

Rates: Monthly

Residential

First 1,000 gallons	\$ 6.60 Minimum Bill
Next 9,000 gallons	2.50 per 1,000 gallons
Over 10,000 gallons	2.10 per 1,000 gallons

Commercial

First 5,000 gallons	\$ 16.60 Minimum Bill
Next 5,000 gallons	2.50 per 1,000 gallons
Over 10,000 gallons	2.10 per 1,000 gallons

Industrial

First 20,000 gallons	\$ 50.10 Minimum Bill
Over 20,000 gallons	2.10 per 1,000 gallons